



Before the  
DEPARTMENT OF COMMERCE  
National Telecommunications and Information Administration

Request for Comments on the Internet	)	NTIA Docket No.
Assigned Numbers Authority (IANA)	)	110207099–1099–01
Functions	)	

**COMMENTS OF MICHAEL PALAGE<sup>1</sup> AND BERIN SZOKA<sup>2</sup>**

As supporters of the private sector-led, multi-stakeholder model on which the Internet Corporation for Assigned Names and Numbers (ICANN) was founded, we believe that the IANA services arrangement, currently held by ICANN, is the key to ensuring the accountability, transparency and cost-effectiveness of Internet governance. We therefore applaud the NTIA for using the broad scope of this NOI to undertake a comprehensive review of the IANA services. This review could not be more timely, as ICANN stands at an “inflection point,” as it matures, *sua sponte*, from a humble non-profit with a narrow technical coordinating mandate into something much larger and more powerful—but not necessarily better.

Ira Magaziner, one of the fathers of ICANN put it best when he said, in his recent welcome speech at ICANN’s San Francisco meeting:

ICANN must take great pains to operate in an efficient manner. It is a public service organization with a technical mission that should be frugal, and it must always have humility in the way it works. Its leaders must avoid trying to build an empire. I think you will be best served by doing what you need to be doing, to be focused on but not build something that’s too big an empire because a bigger empire becomes a bigger target.<sup>3</sup>

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<sup>3</sup> Comments of Ira Magaziner at ICANN Meeting Welcome Session, March 24, 2011, <http://svsf40.icann.org/meetings/siliconvalley2011/transcript-welcome-14mar11-en.txt>.

## The Formal Structure of any Future IANA Services Agreement Does Obviate the Cost Recovery Mandate for Such Services

In his response to the NOI, ICANN President Rod Beckstrom asserts that the Department of Commerce had always planned, “Once ICANN was firmly established ... [to] fully transfer the management of [the IANA] functions to the private sector.” He argues NTIA should now transition the IANA function from a procurement contract to a cooperative agreement.<sup>4</sup> But whatever NTIA does with the IANA function, ICANN will—and must—remain subject to the controlling legal opinion issued by the General Accounting Office in 2000:

ICANN is a project partner with the Department under the memorandum of understanding, and it is the Department’s policy to allow project partners to recover only actual project costs. Thus, fees are not prohibited, but ICANN is limited to recovering only actual costs.<sup>5</sup>

This, in essence, is what Magaziner was talking about when he said ICANN “is a public service organization with a technical mission that should be frugal.” Magaziner may have meant his comment in broad moral terms, but the GAO was talking about legal requirements that continue to bind ICANN and restrain it from “empire-building.”

To understand the insightfulness and importance of Magaziner’s admonition, consider the following snapshots of ICANN’s organization growth and operational efficiency over the past several years:

- ICANN’s budget has grown over little more than a decade from a single-digit staff with an annual operating budget of around \$2 million<sup>6</sup> to an operational staff in excess of 120 (not counting numerous consultants and outside vendors) with a \$65+ million budget. Perhaps most troubling is that, with the roll-out of new gTLDs, ICANN’s future annual budgets will quickly exceed \$100 million.
- In the latest proposed gTLD Applicant Guidebook, ICANN proposes to charge new gTLD registry operators \$25,000 per year for the right to register up to 50,000 domain names in a new gTLD.<sup>7</sup> Yet in June 2009 (well *after* the publication of the first draft applicant guidebook), ICANN renewed its contract with the registry operator for the .AERO TLD, SITA, charging SITA only \$5,000 for registering up to 50,000 domain names. So how can ICANN be operating “on a cost recovery basis” while charging some registry operators

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<sup>4</sup> Comments of Rod Beckstrom, ICANN President, NOI, March 24, 2011, <http://www.ntia.doc.gov/comments/110207099-1099-01/attachments/ACF2EF.pdf>

<sup>5</sup> See gTLD Applicant Guidebook Proposed Final Version, November 12, 2010, [www.gao.gov/new.items/og00033r.pdf](http://www.gao.gov/new.items/og00033r.pdf)

<sup>6</sup> All currency references herein are in U.S. Dollars.

<sup>7</sup> Proposed New gTLD Agreement (p168) see <http://www.icann.org/en/topics/new-gtlds/draft-rfp-clean-12nov10-en.pdf>

500% what it charges another? ICANN has yet to provide adequate justification for this proposed five-fold fee increase despite repeated inquiries.<sup>8</sup>

- Similarly, ICANN has yet to justify its 1444% increase in the registry fee it charges VeriSign to operate the .COM registry: from \$125,000 in 2005 to \$18 million just five years later.
- While recent ICANN CFOs/Controllers should be applauded for increasing ICANN's openness and transparency regarding departmental financial accountability, ICANN remains, embarrassingly, a \$65+ million professional service organization that has yet to implement the use of timesheets among its staff—as other similarly sized professional services organizations (*e.g.*, law firms and accounting firms) do. This makes it difficult (if not impossible) to track how much time ICANN's employees spend on particular issues. Without that basic information, how can ICANN possibly operate on a cost recovery basis?

As part of this comprehensive review of the IANA services, NTIA should review how ICANN has collected fees from its contracting parties to pay for these and other services that it provides to the global community as a project partner of the United States Government.

## Historical Analysis of ICANN's Funding Model

### A. ICANN's Original Funding Model

In 2000, ICANN charged gTLD unsponsored registries a *fixed* fee, depending upon the type of registry (unrestricted versus restrictive), independent of the maximum number of domain names registered within that TLD. Thus, in 2002, VeriSign paid ICANN \$100,000/year for the right to operate the .COM registry, which then had over 21 million names—but Afilias paid the same amount for the right to operate the .INFO registry, which had only around 1 million names.<sup>9</sup>

The manner in which ICANN collected its fees from registrars was also fundamentally different from the structure in place today: Back in 2000, ICANN calculated the fees it charged to registrars only after producing an annual budget, dividing the final approved budget by the number of domain names to produce a per-domain name fee charged to registrars every quarter based upon the number of domain names they sponsored.<sup>10</sup>

To clearly illustrate how the number of domain names registered was independent from the total fees collected by ICANN, one need look no further than the quarterly fees collected from the Registrars during the 2001-2002 budgetary cycle: Although the number of gTLD-registered

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<sup>8</sup> See <http://forum.icann.org/lists/op-budget-fy2011/msg00011.html>

<sup>9</sup> Each unsponsored gTLD registry contract had a provision that permitted ICANN to increase the fees it collected automatically by 15% each year beginning in 2002, see .COM Registry Agreement (2001) <http://www.icann.org/en/tlds/agreements/verisign/registry-agmt-com-25may01.htm> Section II, Paragraph 7(D).

<sup>10</sup> This fee ranged from around 4 cents to 18 cents from 1999 to 2003, and sometimes varied within each calendar quarter as the number of domain names increased.

domain names during this period increased from around 30.1 million to around 32.3 million,<sup>11</sup> the revenue collected by ICANN *remained the same* for each quarter at around \$592,250.<sup>12</sup>

## **B. ICANN's Current Funding Model**

This approach changed dramatically when Paul Twomey succeeded Stuart Lynn as President and CEO of ICANN in March 2003. Supported by the newly hired General Counsel John Jeffrey and Vice President Kurt Pritz, Twomey strategically migrated ICANN from this cost recovery model to a transaction-based fee model—in essence, a “domain name tax”—by changing the fees paid by both registrars and registries.

### **1. Taxing Registrants through Registrars**

In public, ICANN justified its transaction-based fee model on the grounds that it would provide a more secure, stable and predictable funding stream for ICANN. But the argument communicated to registrars was that, if they knew the variable registrar fee in advance, they could simply pass this fee/cost/tax directly through to the end-user/registrant.

Not only did this model create greater predictability for registrars, it actually saved them money. Previously, registrars had to estimate what the variable registrar fee would be each year based upon historic trends and incorporate that estimated fee in the prices charged to registrants for domain name registrations that year. If the registrar under-estimated the actual fee, which ICANN calculated on a quarterly basis, it potentially had to “eat” any shortage. Thus, it was no surprise that, shortly after the implementation of this new “transactional model” fee structure, most registrars simply passed this pre-specified cost directly through to registrants as a surcharge on top of the cost of the domain name. This meant that consumers ended up paying millions of dollars a year in this new \$0.25 global “domain name tax” levied by a unique, and increasingly powerful, California non-profit corporation.<sup>13</sup>

While the difference paid by most registrants was small, the overall results of this paradigm shift in ICANN's revenue model were enormous: Instead of setting its fees *after the fact* based on recovery of actual costs incurred in providing its technical coordination services every quarter or year, ICANN began locking in its per-domain fees based on the projected growth of the name space. This seemingly small change in methodology opened the floodgates of new revenue, because even small increases in registration fees above ICANN's costs meant pure profit for ICANN.

These small profits per domain spread across millions of domains allowed ICANN to “sit back and watch the money roll in” as the number of domain name registrations continued to grow—and with them, automatically, ICANN's revenues. This also created a material and direct economic incentive for ICANN to increase the overall numbers of domain names registered, as

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<sup>11</sup> <http://www.zooknic.com/Domains/counts.html>

<sup>12</sup> <http://www.icann.org/en/financials/gtld-contribution-chart-01-02.htm>

<sup>13</sup> This registrar variable fee is now \$0.18.

ICANN's economic financial interests were now directly tied to those of the registrars: More domain names registered meant more money for both the registrars and ICANN.

ICANN rightfully boasts that, since it first allowed competitive registrars in 1999, it has saved consumers/registrants upwards a billion dollars every year in lower domain name registration costs.<sup>14</sup> But, in its history books and its previous report cards to the USG as part of the MoU/JPA, ICANN never mentions the multi-million dollar tax it has imposed on consumers in the form of domain name registration fees that are no longer based on recovery of ICANN's costs—and thus higher than they really need to be.

## 2. Taxing Registries

But ICANN's revenue-maximization efforts didn't stop with this new influx of fees paid by registrants through registrars. The second part of ICANN staff's "sales pitch" to the registrar community was that ICANN would seek to have registries pay a greater portion of ICANN's operating costs. But ICANN didn't tell registrars that "selling" the registries on their newly increased contributions would likely require sweetening registry contracts with new provisions such as presumptions of renewal and allowing registries to raise prices without ICANN's explicit approval.

As ICANN began restructuring the registry contracts towards their current form, it abandoned the flat-fee billing rate per registry and instead required registries to pay a per-domain name fee. In the first iteration of these registry contracts, the fee each registry paid per domain name varied widely. For example, in spring 2005, the registry operators for .TRAVEL and .JOBS became the first gTLD registries to pay ICANN a \$2/domain per year "registry level transaction fee."<sup>15</sup> Shortly thereafter, in June 2005, ICANN declared VeriSign the winner of the .NET RFP; VeriSign's new registry agreement provided for a \$.75/domain per year "registry level transaction fee."<sup>16</sup>

In the spring of 2006, ICANN executed a new registry agreement with VeriSign for the .COM registry as part of their agreement to settle a long-standing dispute.<sup>17</sup> ICANN created a byzantine fee structure that can be simplified as follows: VeriSign agreed to pay ICANN \$12

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<sup>14</sup> See <http://www.pch.net/purpose/PfP1-TheresaSwinehart.pdf> (Slide 9) where ICANN claims a one billion dollar reduction in domain name registration fees. See also ICANN Congressional testimony of President and CEO Paul Twomey and General Counsel John Jeffery where each claim a reduction in domain name fees of up to 80%: <http://www.icann.org/presentations/PaulTwomey-Testimony-30sep04.pdf> and <http://www.icann.org/correspondence/jeffrey-testimony-07jun06.htm>

<sup>15</sup> See the .JOBS registry contract Section 7.2.c at <http://www.icann.org/en/tlds/agreements/jobs/jobs-agreement.htm> or the .TRAVEL registry contract Section VII.2.c at <http://www.icann.org/en/tlds/agreements/travel/travel-agreement-12apr06.htm>

<sup>16</sup> See the .NET registry contract at Section 7.2.c, <http://www.icann.org/en/tlds/agreements/net/net-registry-agreement-01jul05.html>

<sup>17</sup> See <http://www.icann.org/en/tlds/agreements/verisign/ICANN-VRSN-settlement-agreement-2005.pdf> (settlement agreement) and <http://www.icann.org/en/tlds/agreements/verisign/registry-agmt-com-01mar06.htm> (.COM Registry Agreement).

million a year (\$3 million per quarter) for the right to operate the .COM registry. This fee increased by another \$6 million a year (\$1.5 million per quarter) due to certain escalation clauses tied to the number of domain names registered in the .COM registry, to the current \$18 million a year VeriSign pays annually.

Two remarkable aspects of the .COM registry agreement merit examination. First, while this agreement does explicitly contain a per-domain name transaction fee, simple math reveals that if you divide the maximum revenue associated with the .COM registry contract (\$18 million) by the volume of registrations that triggered this price (70 million domain names) you will arrive at a \$0.25/domain per year “registry level transaction fee.”<sup>18</sup>

Second, this agreement provided that, if the number of domain names registered in .COM should drop below the 70, 60 or 50 million name thresholds, VeriSign could decrease the amount it paid ICANN by \$25,000 per month for every decline of 1 million names. Again, basic math reveals that \$25,000 per month equates to \$300,000 annually, and if you divide this figure by \$6,000,000 (the total revenue that VeriSign would have lost from losing 1 million names at \$6 per domain name—the registration price at the time), you will find that this reduction equates to exactly 5% of the registry’s revenue. Conveniently, this 5% rate happens to be precisely the same 5% tax ICANN proposed to charge the registries operating new gTLDs in the template registry agreement included in the original Draft Applicant Guidebook.<sup>19</sup>

Similarly, in December of 2006, the ICANN Board approved the renewal of .BIZ, .INFO and .ORG registry agreements. These three contracts all provided for the following escalating per domain year “registry level transaction fee:”

2007	-	\$0.15
2008	-	\$0.15
2009	-	\$0.20
2010	-	\$0.20
2011	-	\$0.25
2012	-	\$0.25

Unsurprisingly, shortly after the execution of these new registry agreements, the .INFO, .BIZ and .ORG registries all began to raise their prices for consumers. While one could speculate as to why the registries did so, at least one gTLD registry—Neustar, which operates .BIZ—specifically pointed to ICANN’s increased fees.<sup>20</sup> Thus, hidden behind needlessly complicated

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<sup>18</sup> There were approximately 50 million names registered in the .COM registry at the time of execution, and the two trigger provisions in the .COM registry agreement was an addition of 10 & 20 million names registered in excess of the baseline 50 million threshold.

<sup>19</sup> The 5% revenue tax on registry operations was dropped in subsequent Applicant Guidebook drafts and replaced with the proposed \$0.25 per domain name fee for registries in excess of 50,000 domain names.

<sup>20</sup> “Given these dynamics in the marketplace and the recent fee increase imposed by ICANN on the Registry for .BIZ domains, we have decided to increase the per domain fee for all unreserved .BIZ domains” See <http://www.icann.org/correspondence/switzer-to-twomey-23nov08.pdf>

math in ICANN's contracts, ICANN has again quietly imposed a global domain name tax on consumers—which it has conveniently omitted from its history books.

Two other gTLD registries contracts merit close attention, not for what their original terms provided, but for what their amended terms permitted. The .MOBI and .TEL registries were both approved as part of the 2004 sTLD round: In July 2005, mTLD became the first in the round to execute a contract with ICANN, while Telnic became one of the last in the round to do so in May 2006. Both these registry agreements initially included a \$0.75 per-domain name per year “registry level transaction fee.” But both registries sought contractual amendments from ICANN to lower their per-domain name fee to facilitate marketing initiatives based on lower registrar price points. ICANN granted the requested reductions for both the .MOBI<sup>21</sup> and .TEL<sup>22</sup> registries. Once again, the restructured fee equates to that same 5% domain name tax based upon the price the registry charges the registrar.

Once ICANN had started down the path of rewriting the gTLD registry contracts, it had achieved the three critical elements that made possible the subsequent, and continuing, explosion of its budget. First, ICANN increased the annual fees it collected from gTLD registries from a few hundred thousand dollars to in excess of \$25 million. Second, ICANN removed the strict price controls that had caused some to claim that ICANN was acting as a regulator of gTLD domain name services. Third, and most importantly, ICANN removed contractual safeguards in the registry contracts intended to provide the community with a throttle on the size of ICANN's budgetary growth. These safeguards had limited how much money ICANN could extract from the registries and registrars, so once they were removed there was no effective limit on the growth of ICANN's budget.

### Solving ICANN's Tri-Polar Disorder

The ICANN bylaws are unwavering in defining ICANN's mission. Article I, Section 1 sets forth in clear and unambiguous language that it is ICANN's mission to:

- **“Coordinate”** the allocation and assignment of unique identifiers;
- **“Coordinate”** the operation and evolution of the DNS root name server system; and
- **“Coordinate”** policy development reasonably and appropriately related to these technical functions.<sup>23</sup>

Under the auspices of promoting the “security and stability” of the Internet and buttressed by an ever-increasing annual budget, ICANN has far exceeded its intended, limited role as a mere technical coordinating body and is now evolving into something more akin to an “Internet czar,” expanding its “sphere of influence” into operational, regulatory and coordinating matters. Failure to refocus ICANN on its narrow technical coordinating mission will likely lead

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<sup>21</sup> <http://www.icann.org/en/tlds/agreements/mobi/registry-agmt-amend1-mobi-01jan07.htm>

<sup>22</sup> <http://www.icann.org/en/tlds/agreements/tel/registry-agmt-amendment-09jul07.htm>

<sup>23</sup> ICANN Bylaws, <http://www.icann.org/en/general/bylaws.htm>



to the failure of the private sector led model—and the very kind of “empire-building” Magaziner recently warned about.

Dr. Hamadoun Touré, Secretary General of the International Telecommunication Union (ITU), has reminded the broader Internet community of the need for a global coordinating body to firewall itself from the operation of the infrastructure and assets that it is supposed to be coordinating.<sup>24</sup> But rather than seeking to phase-out its hands-on operation of such key Internet infrastructure such as the .INT and .ARPA registries, ICANN, in its comments on this NOI, proposed to retain its operational role in connection with this key Internet infrastructure. Empires, almost by definition, do not cede territory willingly.

ICANN’s hands-on technical operation of these critical Internet resources is not only inconsistent with its declared mission as a global “coordinating” body, but is also, in some cases, a clear violation of its own Bylaws. Specifically, ICANN currently serves as the Registry Operator of the .INT and .ARPA gTLDs as part of the IANA contract. But Article II, Section 2 of the ICANN Bylaws state that “ICANN shall not act as a Domain Name System Registry or Registrar or Internet Protocol Address Registry in competition with entities affected by the policies of ICANN.”

While the broader Internet community appreciates the many operational and coordinating roles that ICANN served during its formative years, the time has now come for ICANN, maturing into a global coordinating body, to give up hands-on technical operation of these key Internet resources and instead focus on its coordinating responsibilities. ICANN’s current Bylaws require nothing less. This firewalling of responsibilities is not only prudent from a governance standpoint, but would also remove the conflict of interests created when ICANN seeks to coordinate its own actions along with those of others regarding operation of these critical Internet resources.

While the bright line that should separate ICANN’s mere technical coordinating functions from the operation of key Internet infrastructure has been blurring for some time, perhaps the bigger danger confronting ICANN is the slippery regulatory slope upon which ICANN now finds itself.

The recent ICANN Board resolution (2011.03.18.23) authorizing the execution of the proposed .XXX sTLD registry contract<sup>25</sup> positions ICANN to expand its role as an Internet-czar into content regulation. Specifically, the current draft ICM Registry agreement calls for a prohibition on the “display [of any] any photograph, film, video, picture, or computer or computer-generated image or picture, whether made or produced by electronic, mechanical, or other means,

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<sup>24</sup> Speech at the ICANN regional meeting in Cairo, Egypt, Nov. 6, 2008, <http://cai.icann.org/files/meetings/cairo2008/toure-speech-06nov08.txt> (“ITU is not doing any operational issues.”; “They also charge us with facilitating on key issues of interest to our members, such as IDN and the global management resources, but not at operational level.”; “There is one clear limitation for ITU. We don’t do operational matters. No.”).

<sup>25</sup> <http://www.icann.org/en/minutes/resolutions-18mar11-en.htm#5>.



depicting child pornography as defined in the United Nations Convention on the Rights of the Child.” While these are prudent restrictions, which the Registry Operator itself proposed, their explicit inclusion into an ICANN registry agreement now creates an affirmative obligation on ICANN to police and enforce their contractual restriction. Where will this precedent lead? At what point might “coordination” give way to outright censorship, as the gTLD space expands?

Failure of the USG to hardcode operational/coordinating/regulatory firewalls into the IANA services agreement will undermine the long term viability of the private sector-led model.

### Proposed Recommendations

Listed below are the proposed recommendations for the NTIA in connection with provisioning future IANA services.

- There should be hardcoded in any RFP(s) for the IANA services that all applicants must affirmatively pledge that they shall not operate any Internet infrastructure and instead focus exclusively on the technical coordinating functions associated with the IANA services.
- There should be an additional requirement in any RFP(s) for the IANA services that require all applicants must institute suitable accounting procedures (*e.g.*, employee timekeeping) to ensure that the IANA services are provided on a cost-recovery basis.
- The current IANA services should be unbundled into the following five RFPs: (1) coordinating the assignment of technical protocol parameters; (2) Internet root zone management; (3) IP address allocation; (4) the sponsorship of the .INT TLD; and (5) the sponsorship of the .ARPA TLD. However, in light of the operational/coordinator bifurcation proposed above, any successful applicant/sponsor for the .INT and .ARPA RFPs should be required to designate a suitably qualified operational infrastructure provider to operate the respective TLDs.
- If an ideally suited applicant such as the Internet Engineering Task Force (IETF) or the Internet Architecture Board (IAB) were to submit an application for the protocol parameters IANA services RFP, such arrangement should have a minimum ten year duration composed of five-year renewable terms.
- The same term structure should apply if an ideally suited applicant such as the Number Resource Organization (NRO) were to submit an application for the IP address IANA services.
- The Internet root zone management is probably the most difficult IANA service to address at this time because of a number of dynamic issues, the pending new gTLD implementation and a number of ongoing ccNSO policy initiatives as identified in the CCNSO NOI submission.<sup>26</sup> In light of this dynamic nature any relationship with a successful RFP applicant should have a maximum of a five year term composed of one-year renewal terms. It would also be prudent for the NTIA to hardcode into any

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<sup>26</sup> <http://www.ntia.doc.gov/comments/110207099-1099-01/attachments/2011-03%20ccNSO%20response%20to%20NTIA%20NOI%20on%20IANA.pdf>

agreement suitable safeguards to address legitimate public policy concerns of the United States and others Governments.

- All five RFPs should propose clearer metrics for cost-effectiveness, accountability and transparency, and ask applicants to suggest additional such metrics. Without clear measures, the broader Internet community will be unable to hold these trustees accountable. These agreements must be pillars of accountability and transparency in the Domain Name System.

## Conclusion

ICANN claims to be a consensus-driven bottom-up stakeholder organization, yet its comments on the NOI appear to take a top-down management view of these IANA services. Specifically, ICANN is claiming that the USG should enter into a cooperative agreement with ICANN, and that ICANN “would continue to perform these functions under separate agreements with the relevant international technical bodies such as the IAB/IETF and Number Resources Organization (NRO).”<sup>27</sup>

Instead of this top-down delegation, a bottom-up delegation might be more prudent. Specifically, the Commerce Department should enter into separate agreements with the IETF/IAB and the NRO. These organizations would be free to voluntarily participate in the ICANN model, instead of the IETF/IAB and NRO being held hostage to the ICANN model because ICANN is the solo USG delegee of IANA services.

The timeliness of this comprehensive review of the IANA agreement would allow for a refocusing of the technical coordinating functions of the IANA services with adequate safeguards to ensure that the trustees of these services operate them on a cost recovery basis and not in a manner that could be confused with a redistribution of wealth within the domain name ecosystem.

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<sup>27</sup> *Supra* note 4 at 6.